

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
PETITION FOR
REHEARING
EN BANC**

77-7013

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

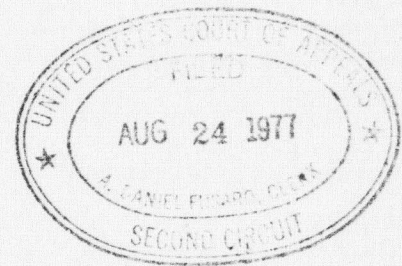
BROWNING DEBENTURE HOLDERS'
COMMITTEE, et al.,

Plaintiffs-Appellants,

-against-

DASA CORPORATION, et al.

Defendants-Appellees.



ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PETITION FOR DEFENDANT-APPELLEE DASA
CORPORATION FOR REHEARING EN BANC

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PETITION FOR DEFENDANT-APPELLEE DASA
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This petition is respectfully submitted to request a rehearing and review en banc of the standards for determining the appropriateness of an award of attorneys' fees under the equitable powers of a federal court against a party who commences an action in bad faith, as set forth in a decision of this Court dated August 11, 1977.

Preliminary Statement

By the August 11, 1977 decision, this Court affirmed a judgment entered in the United States District Court for the Southern District of New York (Hon. Richard Owen, U.S.D.J.) against plaintiffs-appellants, but remanded for a redetermination on the awards of attorneys' fees to defendants-appellees. The awards were based on findings that the action was instituted and prosecuted in bad faith. This Court agreed that procedural tactics by plaintiffs' attorney in the prosecution of the action were employed in bad faith, but disagreed with Judge Owen's finding that the action was commenced in bad faith.

This action arose out of a proposal by defendant-appellee DASA Corporation to sell certain computer assets in order to obtain working capital and pay certain senior indebtedness. Consents of DASA's Debenture Holders to such sale were solicited. In connection therewith, consents were also solicited to a reduction of the Debenture conversion price to \$21. Although the Indenture pursuant to which the Debentures were issued did not require any reduction in the conversion price, plaintiffs demanded that the price be reduced even further. When that demand was refused, they commenced the action claiming, among other things, that the Solicitation Letter sent by DASA's management to obtain the consents contained misstatements and omissions in violation of

§14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(a), and that DASA's directors breached a fiduciary duty to the Debenture Holders in refusing to reduce the conversion price to a figure related to the market price of DASA's common stock.

Judge Owen's finding that the action was instituted in bad faith was based upon (a) his assessment of the credibility of plaintiffs and their attorney and of their motives, and (b) his conclusion that none of the many claims made by them had any factual basis. He also stated that the finding of procedural bad faith supported his finding that the action was commenced in bad faith. Browning Debenture Holders' Committee v. DASA Corp., 431 F. Supp. 959, 964, 966 (S.D.N.Y. 1976, 1977).

Notwithstanding the very substantial evidence supporting Judge Owen's finding on the bad faith commencement of the action, this Court, on the basis of a cold record, and one which was only partially produced, disagreed with that finding. Although this Court agreed that the numerous claims of omissions and misstatements in DASA's Solicitation Letter to Debenture Holders were either baseless or unsubstantiated (Slip. Op., p.5229), it concluded that one solitary claim of plaintiffs -- the "fiduciary duty" claim -- was colorable and provided a fair ground for litigation, although not under federal law (Slip. Op., p.5237).

Errors Assigned

It is respectfully submitted that the standards indicated in this Court's decision are incorrect for two reasons. First, where a District Judge's finding of bad faith is based upon substantial evidence and personal observations of the parties, it should not be overturned unless it is clearly erroneous. Second, a finding of bad faith, based upon a determination that numerous false claims were asserted with knowledge of their falsity in order to obtain a financial advantage, should not be overturned simply because one of these numerous claims, although invalid, was at least colorable.

We submit that the question to be considered by an appellate court in reviewing the propriety of an award of attorneys' fees under the equitable powers of a federal court is not whether the complaint includes a colorable claim. Rather, the question is whether the district judge was clearly erroneous in concluding, on the basis of the evidence, his observations of the parties and assessments of their credibility, that the plaintiffs knew at the time of commencement of the action that the allegations in the complaint were without substance, and nevertheless used the Court as a weapon. As will be seen, the decision to award attorneys' fees here was more than amply supported.

We submit that the standard of accountability for the improper use of overcrowded courts is a matter of exceptional importance, and therefore suggest a rehearing en banc.

POINT I

THE "FIDUCIARY DUTY"
CLAIM WAS SPECIOUS

Although the words "fiduciary duty" were continually employed by plaintiffs, they do not even arguably apply to the transaction in issue. DASA had been suffering from serious financial difficulties. The sale of assets was proposed to alleviate these difficulties. Even plaintiffs asserted (Ex. 56, pp. 8-9)* that the sale was so vital to DASA's continued operations that, if the Debenture Holders did not consent to it, "it is extremely difficult to imagine how DASA will be able to continue operations for very many months more."

DASA's directors are not alleged to have obtained any personal benefit from this transaction at the expense of other security holders. The characterization of this transaction as a breach of "fiduciary duty" is one which in no way applies to the facts.

*References to exhibits in evidence at the trial appear herein as "(Ex. __)".

By the Solicitation Letter (Ex. 4), the Debenture Holders were given all of the pertinent information concerning the transaction, as this Court has found. They were informed of the existing conversion price of the Debentures (\$42.42), the proposed new conversion price (\$21.00), the contemporaneous market price of DASA's common stock (\$4.50) (Ex. 4, p.3) and the security holdings of management (Ex. 4, pp.24-25). And in a supplemental solicitation letter from DASA's management (Ex. 98), the Debenture Holders were informed of the position of plaintiffs with regard to the balance of interests of DASA's security holders, of the commencement of this action, of the claims made, and of the relief sought. Nevertheless, as has been noted, the holders of approximately 70% in principal amount of the Debentures approved the transaction.

Five of DASA's officers and directors owned DASA stock having an aggregate market value of approximately \$150,000 and two officers and directors had direct and indirect interests in Debentures having an aggregate market value of nearly that amount (Ex. 4, pp.24-25). Yet none of these officers or directors received or is alleged to have received any benefit from the transaction not shared pro rata by other security holders of DASA. The "fiduciary duty" claim amounted to nothing more than words used by plaintiffs, who, as will be seen, knew that their claim was specious.

If plaintiffs really believed that the "fiduciary duty" claim was colorable, why did they make every effort to avoid the trial? Santa Fe Industries, Inc. v. Green, 51 L.Ed.2d 480 (1977), was not decided until long after the trial in this action in 1975. Yet, when faced with the prospect of a trial, plaintiffs sought a stay in the District Court, mandamus in this Court, made numerous motions and engaged in various tactics in a desperate frenzy to avoid a trial. It is quite apparent that plaintiffs knew that there were no facts to support this "fiduciary duty" claim or any of their other claims. The finding of the District Court of bad faith motivation was more than amply supported.

The finding of bad faith procedural tactics did not merely furnish an independent basis for the decision to award attorneys' fees; it corroborated the finding that the action was commenced in bad faith. Plaintiffs' febrile efforts to avoid a trial strongly supports the conclusion that they knew that their claims were without substance.* Browning Debenture Holders' Committee v. DASA Corp., supra, at 964.

*Similarly, plaintiffs' failure to serve process on DASA's directors -- the objects of the "fiduciary duty" claim -- until one week before plaintiffs were forced to trial, further confirms the fact that this was not a bona fide action to enforce a fiduciary duty.

POINT II

EVEN IF THE "FIDUCIARY DUTY" CLAIM WERE COLORABLE, THE DECISION TO AWARD ATTORNEYS' FEES, BASED ON A FINDING THAT THE ACTION WAS COMMENCED IN BAD FAITH, WAS CORRECT

The District Court did not conclude that this action was commenced in bad faith because it disagreed with the plaintiffs' "fiduciary duty" theory. Rather, it concluded that numerous baseless charges of proxy fraud were made in order to achieve a collateral result. Even if the "fiduciary duty" claim were colorable, what possible justification did plaintiffs have for making the voluminous factitious charges of proxy fraud, which in several instances simply misstated disclosures actually made? It is submitted that the District Court was correct in concluding that a false Complaint was filed solely to fulfill plaintiffs' threat to commence litigation if DASA's management would not reduce the conversion price to a figure based on the market price of DASA's common stock, which litigation, plaintiffs had said,

"might seriously delay (or prevent altogether) the proposed sale of computer assets and otherwise work in ways damaging to the operations of the Corporation and the interests of the Corporation's shareholders and creditors alike." (Ex. 57, p.4).

These false charges of proxy violations were included in a 54-page Complaint, to which numerous exhibits were appended, and which, together with other papers, were submitted

in support of a motion for a preliminary injunction against the sale of computer assets. The sheer volume of paper and multitude of accusations insured that the delay of the sale threatened by plaintiffs would result.

The costs of defending this action were incurred because of these baseless charges of proxy fraud, and not because of the "fiduciary duty" claim. Claim 3 of the Complaint herein was asserted under §14(a) of the Securities Exchange Act of 1934, which is solely a disclosure statute, unlike §10(b), which was considered in Santa Fe Industries, Inc. v. Green, supra, and which prohibits a "manipulative or deceptive device or contrivance". If plaintiffs had merely asserted their "fiduciary duty" claim without including the unrelated sundry charges of proxy fraud, this action could have been disposed of by motion at its inception, so that the expenses required to defend it would not have been incurred.

We reiterate our contention that the invocation of the judicial process entails concomitant burdens upon the parties, the courts, other litigants and the taxpayers who support the judicial system. These burdens are accepted as the fair cost of a fundamental right. But the right to invoke that process implies the obligation to do so responsibly and in good faith. Improperly motivated and vexatious litigation constitutes an unfair imposition upon all others who share these burdens -- the taxpayers, the opposing parties, the courts,

and other litigants competing for the time and attention of the courts. Such litigation warrants a reallocation of the burdens, both in the interest of justice and to deter others from committing similar abuses. It is respectfully submitted that the standard set forth in this Court's decision for determining what constitutes bad faith can only encourage the most undesirable kind of litigation, at the expense of all others who share these burdens.

Pursuant to the Section 11.06 of the Indenture between DASA and The Bank of New York (the "Bank") (Ex. 1, pp.62-63), DASA is required to indemnify the Bank for its attorneys' fees and expenses incurred in the defense of this action. Hence, DASA has been doubly injured by this improperly motivated lawsuit. The real victims are, of course, the stockholders and Debenture Holders which plaintiffs had the temerity to claim to represent.

The District Court awarded the Bank \$7,000, although total fees incurred by the Bank amounted to \$30,000.* This Court has suggested that this amount might have to be reduced even further (Slip. Op., p.5238), thereby shifting the expense to DASA and ultimately to its security holders -- a result which is particularly unfair in view of the express determination by this Court that the claim against the Bank

*See affidavit of D. M. Olasov of Sullivan & Cromwell, sworn to November 5, 1976, in support of application for an award to the Bank.

was frivolous (Slip. Op., p.5227).*

Fed.R.Civ.P. 52(a) provides that findings of fact by the district court "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." This Court, on the basis of a partial record, determined that the finding of the District Court that the action was improperly motivated and commenced in bad faith was erroneous, simply because one of a multitude of claims was colorable, and notwithstanding the fact that the District Judge concluded from his observations of the parties and assessments of their credibility that all of the many other claims were falsely made solely to effectuate a collateral result. It is respectfully submitted that this Court was incorrect both in its determination of the facts and the legal standards applicable thereto.

The test stated by this Court for determining bad faith, as applied here, correctly recognizes the interests of those with novel claims and their rights to test them in federal courts. We respectfully submit, however, that it fails to give due weight to the rights of the victims of improperly motivated litigants or the interests of others who bear the burdens imposed upon invocation of the judicial

*The Bank had made earlier attempts to require plaintiffs to post a bond, but was frustrated by the successive transfers of this action to new judges, each of whom needed time to become sufficiently familiar with the extensive record to determine that the claim against the Bank was frivolous.

processes. It also appears to give little credit to the abilities of district judges to distinguish bona fide novel claims from those asserted for improper purposes.

Moreover, we respectfully submit that the test stated and applied here fails to give any consideration to the fact that the District Judge here reached his firmly-supported conclusion from his personal observations of the parties and assessment of their credibility. Nor does it take into account the fact that the damage here resulted from the assertion of the numerous claims found to be without color, and not from the sole claim found to be colorable and which could have been disposed of by motion five years ago.

In short, the test enunciated and applied here effects the practical nullification of the equitable powers of a federal court to award counsel fees to the victim of an action commenced in bad faith. We submit that if bad faith was not properly found here, it can never be properly found anywhere.

POINT III

AN AFFIRMANCE OF THE FINDING
THAT THE ACTION WAS COMMENCED
IN BAD FAITH WILL OBVIATE THE
NEED FOR AN ALLOCATION AMONG
PLAINTIFFS

Since each of the plaintiffs participated in the decision to commence this improperly-motivated action, there

will be no need for a remand to assess the individual responsibility of each plaintiff if the finding of the bad-faith commencement of the action is affirmed. Such an individual assessment would otherwise be required pursuant to this Court's decision (Slip. Op., p.5239) if the awards were based solely on procedural bad faith.*

At the trial, plaintiff Simms Browning admitted that he knew that several summary judgment motions had been made and three appeals filed already, which he said he authorized (Browning Tr., pp. 207-208). Similarly, plaintiff Roy Brewer admitted that he participated in the decision-making processes of the Committee in connection with the litigation and received copies of documents related to it (Brewer Tr., p.6). On the basis of the record presented, the District Judge quite properly declined, in the exercise of his discretion, to apportion responsibility for the awards of attorneys' fees among the plaintiffs. Browning Debenture Holders' Committee v. DASA Corp., supra, at 967.

Even if, contrary to the record, plaintiffs Roy Brewer and Simms Browning were innocent, it is submitted

*Section 315(e) of the Trust Indenture Act, 15 U.S.C. §7700o(e), and Section 10.11 of the Indenture (Ex. 1, p.58), authorize an award of attorneys' fees to DASA for the expenses reasonably required to obtain a dismissal, in addition to the expenses incurred in defending the bad faith procedural tactics. Both the statute and the Indenture provision authorize the assessment of attorneys' fees against any party litigant, but neither limits the authorization to award such fees to the Indenture trustee only.

that as between innocent parties, those who chose the attorney should bear the consequences of his action, notwithstanding the fact that bad faith is indeed personal. Plaintiffs' remedy against their attorney is in the state courts.

Moreover, such a result would avoid the difficult problems which would arise from the need to conduct an inquiry into communications between plaintiffs' attorney and his clients, which would presumably be necessary to assess individual responsibility. More significantly, it would avoid the unseemly conflict of interest which would be created between plaintiffs' attorney and plaintiff Roy Brewer.

In any event, if the amply-supported finding of the District Court that the action was commenced in bad faith is affirmed, there will be no need to reach these issues, since all of the plaintiffs must bear the responsibility therefor.

Conclusion

For the foregoing reasons, it is respectfully submitted that the Court should grant a rehearing en banc, and on rehearing the judgment below awarding attorneys' fees should be affirmed in all respects.

Respectfully submitted,

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Attorneys for Defendant-
Appellee DASA Corporation

I. MICHAEL BAYDA

Of Counsel

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
 : ss.:
COUNTY OF NEW YORK)

JEFFREY SLONIM, being duly sworn, deposes and
says:

That he is not a party to the action, is over 18
years of age, and resides at 2815 Coyle Street, Brooklyn,
New York 11235; and that on the 24th day of August, 1977,
deponent served copies of the annexed Petition upon

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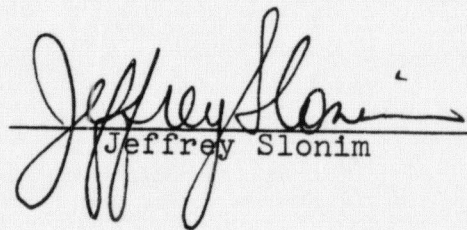
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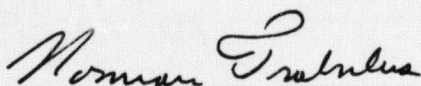
at

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the addresses designated by said attorneys for such purpose,
by depositing true copies of the same in postpaid properly
addressed sealed wrappers in an official depository under
the exclusive care and custody of the United States Postal
Service within the State of New York.


Jeffrey Slonim

Sworn to before me this
24th day of August, 1977


Notary Public

NORMAN TRABULUS
Notary Public, State of New York
No. 31-11415
Qualified in New York County
Commission Expires March 30, 1979